analysis persuades us that there are two limited classes of operators that should not be required to adjust their rates in this manner until we develop a better picture of the price/cost profiles of these operators. The requirement to set rates according to the general rule thus will not apply to regulated cable systems that fall into one of two categories of systems eligible for transition relief.

110. The first category eligible for transition relief consists of systems owned by "small operators," a term defined below as cable operators which have a total subscriber base of 15,000 or fewer customers and which are not affiliated with a larger operator. The second category consists of (i) systems whose March 31, 1994 rates are at below the revised benchmark and (ii) systems whose March 31, 1994 rates are above the benchmark but whose permitted rates are at or below the benchmark.

111. Systems eligible for transition relief will not be required to make the full reduction otherwise required until the Commission has collected and analyzed data about such operators' prices and costs, and determined whether such a reduction is not inappropriate. We anticipate that some of these price/cost data will be collected through a cost study to be conducted by Commission staff over the next six to nine months,[143] while other data will be submitted to the agency by the affected cable systems in a proceeding on this issue to be initiated shortly. The relevant price/cost data then will be aggregated and analyzed so that they can be applied on an industry-wide, rather than a system-by-system, basis.[144] At the conclusion of our analysis, systems eligible for transition relief will be required to make the full reduction unless the analysis reveals that application of the 17 percent competitive differential to these systems is

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showing that their rates will be set at the level justified by those costs, even if that level is below the rates to which they would have been entitled had they used the benchmark system. See Rate Order at para 272.

[143] This cost study will be conducted in connection with the development of final cost-of-service rules for cable operators. We adopted interim cost-of-service standards in a companion order also released today. See Cost Proceeding.

[144] Systems entitled to transition relief who believe that these industry figures do not result in adequate rates may elect to make a cost-of service showing to justify rates at the end of the transition period.

inappropriate.[145]

112. For all cable systems subject to regulation, the rates permitted for the period from September 1, 1993 until May 15, 1994 (the effective date of these new rules), and refund liability with respect to such rates, will be determined by our initial rate regulations adopted on April 1, 1993. The lawfulness of rates in effect on or after May 15, 1994, and refund liability with respect to such rates, will be determined in accordance with the new rules adopted herein.

113. The specifics of how the new rules will be applied, and how cable systems and regulators should transition from the old rules to the new rules, is discussed in detail in the following sections. In addition, the specific calculations a regulated cable system will need to use to apply the revised benchmark system are set forth in new FCC Form 1200.

a. Systems Not Entitled to Transition Relief

114. As noted above, regulated cable systems that are not entitled to transition relief[146] will be required to set their rates at a level that equals their September 30, 1992 regulated revenues per subscriber reduced by the revised 17 percent competitive differential and floated forward for certain adjustments.[147] As under the old benchmark system, we are using September 30, 1992 regulated rate levels as our starting point to avoid building into permitted rate levels any unwarranted rate increases that may have occurred after the 1992 Cable Act was

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[145] In the absence of industry-wide cost data, we are limited in our basis upon which to analyze several issues, including the causes of relatively low, noncompetitive rates as well as the extent to which costs may differ between noncompetitive and competitive small operators. As a result, it is imperative that the industry, in particular small systems and systems whose rates are below the new benchmark, provide detailed cost information through the cost study and the related proceeding in order to resolve the remaining questions regarding cable rates and costs.

[146] As explained in more detail below, regulated cable systems not eligible for transition relief are those systems (1) who are owned by an operator serving more than 15,000 total subscribers and (2) whose rates, after applying the full 17 percent competitive differential as required by our calculations, are above the new benchmark.

[147] Regulated systems wishing to support higher rate levels must submit a cost-of-service showing.

passed but before we adopted our initial rate regulations on April 1, 1993.[148] Applying the revised 17 percent competitive differential to September 30, 1992 rates thus will best ensure that subscribers pay "reasonable" regulated cable rates.

115. As we previously determined, however, a system may have incurred costs since September 30, 1992 that should be reflected in its lawful rate. In particular, we believe that regulated systems should be allowed to include in their permitted regulated rates: (1) the inflation occurring between October 1, 1992 and September 30, 1993;[149] (2) changes in external costs that have occurred since the system became subject to initial regulation at either the local or federal level (or February 28, 1994, whichever was earlier);[150] and (3) changes that have

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[148] See Rate Order at para. 218.

[149] In our April, 1993 Rate Order, we decided to allow inflation adjustments on an annual basis. Rate Order at para. 240. Cable systems will thus be eligible to file for an inflation adjustment for the period beginning October 1, 1993 and ending June 30, 1994 once the final Gross National Product Fixed Weight Price Index (GNP-PI) for the quarter ending June 30, 1994 is released. We are using a June 30 cycle for inflation because the final GNP-PI is generally released 90 days after the end of each quarter. We thus anticipate that operators will have the final GNP-PI figure for June 30, 1994 by September 30, 1994 in time for their first annual rate adjustment.

[150] In the Rate Order, we determined that cable systems would be allowed to increase rates for so-called "external costs" that occurred after the date of initial regulation or February 28, 1994, whichever occurred first. See Rate Order at para. 255. The date of initial regulation, in turn, is defined for the basic service tier as the date on which the cable system receives a notification from its local franchising authority that the authority has become certified and intends to regulate the system's basic service and equipment rates. See 47 C.F.R. Section 76.922(b)(2). For cable programming service rates, the date of initial regulation is the date on which a complaint concerning those rates is filed with the Commission. See 47 C.F.R. Section 76.922(b)(2).

In the Rate Order, we decided that it was not necessary to have a single date of initial regulation for purposes of calculating external costs because we believed that the dates of regulation for the two types of regulated services -- basic and cable programming services -- were likely to be close in time to each other. Rate Order at para. 255, n.607. Experience since that time has taught us that this is not always the case.

resulted from the addition or deletion of program channels to regulated service tiers since September 30, 1992.[151] Accordingly, after reducing its regulated September 30, 1992 rate levels by the 17 percent competitive differential, a regulated system will be allowed to adjust that rate forward for the described changes. The resulting rate will be known as the "full reduction rate."

116. A system whose rate level being justified is above its full reduction rate level must reduce its rate to the full reduction rate level, unless it qualifies for transition treatment as discussed in the sections below.[152] By contrast, a system whose rate level being justified is below the full reduction rate will be permitted to raise its rate level up to the full reduction rate level. This is because the full reduction level establishes the reasonable rate level for that system under our rate regulations. Any cable system that sets its rates at the full reduction rate level will be entitled to adjust those rates in the future for annual inflation, changes in

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Accordingly, to greatly simplify operators' external cost calculations and to enable regulators to better monitor future rate increases, we are modifying our rules on our own motion to provide for a single start date for the accrual of permitted external costs. That date will be the earliest of (1) the date of initial regulation for the basic service tier, (2) the date of initial regulation for cable programming services, or (3) February 28, 1994.

[151] Under our rules, permitted changes in rates to reflect changes in the number of channels on regulated tiers are governed as follows: Channels added to or deleted from regulated tiers between September 30, 1992 and the date of initial regulation (or February 28, 1994, whichever occurs earlier) are handled through application of the old benchmark methodology pursuant to the calculations set forth in FCC Form 393. Channel changes that occur between the date of initial regulation (or February 28, 1994, where applicable) and the effective date of the new rules are accorded external cost treatment only (to reflect changes in programming costs), since going-forward rules to govern those changes had not yet been adopted. Channel changes occurring after the effective date of the new rules will be governed by the going-forward methodology adopted in The Fourth Report and Order, below.

[152] As explained in para. 126, infra, this rate level is measured by the system's average regulated revenue per subscriber.

external costs, and changes in the number of regulated channels.[153]

b. Systems Entitled to Transition Relief

(i) Systems Owned by Small Operators

117. As noted above, systems owned by "small operators" will not be required to reduce rates to the full reduction level immediately. Instead, they will be allowed to cap their rates at their March 31, 1994 levels[154] until we have completed our study of the prices and costs experienced by systems of this type.

118. We adopt this transition approach for cable systems owned by small operators for several reasons. First, evidence submitted by petitioners in this proceeding suggests that smaller systems may face higher than average costs.[155] This evidence is insufficient to allow us to conclude that all small systems face systematically higher costs due to the absence of industry-wide cost data. The information in the record, nonetheless, raises a legitimate question as to whether some systems (and operators) with a limited subscriber base do in fact have unusually high costs (and thus lower-than-average margins). In addition, we are concerned that some small operators may not have the financial wherewithal to withstand the impact of a significant rate

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[153] The requirements for adjusting rates for changes in external costs, inflation and channels on regulated tiers are set forth in Commission rules adopted in this and earlier orders. Operators will use FCC Form 1210 to make these adjustments.

[154] We are using March 31, 1994 as our measure for determining transition treatment because that date is the end of the first quarter in calendar year 1994. As explained at para. 176, we have decided to adopt standardized quarters for calculating quarterly changes in external costs (and annual changes for inflation) in order to greatly simplify the rate-setting process. In addition, use of March 31, 1994 as the start date should prevent small operators from attempting to change their rates (or their status as small operators) before the transition analysis takes place to gain an advantage not intended by our rules. Systems that attempt to engage in such evasive behavior will be subject to sanctions under the rate evasion provisions of our rules.

[155] See e.g., Coalition of Small System Operators, Supplemental Information re: Programming Costs for Large Cable Operators Versus Small Operators (Feb. 15, 1994); Small Business Cable Association, Supplemental Comments in Further Support of Industry Benchmark Adjustments for Low Density and Smaller Cable Operators (Feb. 15, 1994) at 5-10.

reduction. We therefore believe that it is appropriate to study the costs of small operators, and compare those costs with the prices they charge for regulated services and equipment, before requiring them to reduce their rates to the full reduction level.

119. We note, however, that the existing record evidence does not enable us to find that small operators should not eventually be required to apply the full revised competitive differential. Thus, as with other operators subject to transition relief, systems owned by small operators will be required to apply the full 17 percent competitive differential unless the price/cost data we collect persuade us that a smaller competitive differential should be applied to them.[156]

120. For purposes of deciding eligibility for transition relief, systems owned by "small operators" are defined as systems which are owned by operators with a total subscriber base of 15,000 or less as of March 31, 1994, and which are not affiliated with or controlled by larger operators.[157] Our survey of industry rates as of September 30, 1992, the Competitive Survey, revealed that, on average, cable systems charge roughly $20 to $25 each month for all regulated services and equipment.[158] Using this figure to estimate regulated revenue per subscriber, this means that an operator with a total subscriber base of 15,000 earns

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[156] We also note that, in order to ensure a relatively stable regulatory environment, systems owned by small operators will not be required to apply more than the full 17 percent competitive differential, regardless of the results of our price/cost analysis.

[157] Our concern with small operators is aimed at those companies that do not have access to the financial resources or other purchasing discounts of larger companies. We are thus limiting transition relief to small operators that have no such relationship with a larger company. For purposes of determining whether a larger company has a sufficiently significant interest in, or control over, a small operator to give rise to this concern, we will not extend transition treatment to small operators in which a larger company holds more than a 20 percent equity interest (active or passive) or over which a larger company exercises de jure control (such as through a general partnership or majority voting shareholder interest). We believe that in both of these cases, the large company will have a significant enough stake that it will be likely to extend financial resources to the small operator should that operator face financial difficulties.

[158] Competitive Survey as of September 30, 1992.

approximately $3.6 to $4.5 million annually from regulated cable service. We believe that operators who exceed this revenue level are sufficiently large that they will likely be able to apply for bank loans, credit lines or other sources of financing in their communities should application of the full 17 percent competitive differential pose financial difficulties for them. Moreover, as noted above, we have some record evidence that raises the possibility that some small systems serving 1,000 or fewer subscribers may have higher than average costs. Should this prove to be true, we do not believe that these higher costs necessarily will be experienced only by small systems serving 1,000 or fewer subscribers; some systems with slightly larger subscriber bases may also face such costs. Establishing a 15,000 total subscriber base cut-off will thus serve the additional purpose of providing transition relief to a number of smaller systems serving more than 1,000 subscribers that could possibly be found to face unusually high costs.

121. In adopting transition relief for small operators, we need to address two possible complicating scenarios. The first involves a small operator who subsequently purchases, or is purchased by, another cable operator so that the combined subscriber base of the two operators exceeds 15,000. We believe that the small operator in such a situation should not be required to forfeit its transition treatment simply because an acquisition has occurred. We accordingly will grandfather the rate treatment of the small operator pending completion of our cost analysis. We note, however, that the grandfathered treatment will apply only to the systems originally owned by the small operator, and will not extend to the new systems it has acquired (or with which it has been merged).[159] In this way, we will avoid creating any

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[159] Thus, for example, if an operator with 100,000 subscribers acquires a 5,000 subscriber system from a small operator, the 5,000 subscriber system would not have to apply the competitive differential unless and until other systems owned by small operators were required to reduce their rates upon completion of our cost analysis. If a 12,000 subscriber operator were acquired by a 9,000 subscriber operator, the systems owned by both formerly small operators (now one large operator) also would be entitled to retain their eligibility for transition relief. On the other hand, a system owned by a larger operator on March 31, 1994 -- and required to reduce its rates to the full reduction level or to the benchmark -- will not be allowed to reverse that rate cut if it is subsequently acquired by, or acquires, a small operator. For instance, if a 20,000 subscriber

artificial regulatory incentives that either encourage or discourage the acquisition of cable systems by small or large operators.

122. The second scenario that could potentially arise concerns cable operators who cross the 15,000 subscriber demarcation line by either adding or dropping subscribers as their business naturally expands or contracts. A system owned by a small operator on March 31, 1994 that is entitled to transition treatment will not lose its eligibility for that treatment simply because the operator grows above the 15,000 subscriber limit prior to the completion of our cost analysis.[160] Similarly, an operator that exceeds the 15,000 subscriber cut-off on March 31, 1994 will not gain eligibility for transition relief if it subsequently loses sufficient subscribers to bring it below the 15,000 subscriber limit. We believe that these principles are necessary to avoid introducing regulatory incentives for operators either to add or drop subscribers in order take advantage of a particular rate treatment.[161]

(ii) Low-Price Systems

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operator sells a 3,000 subscriber system to a 5,000 subscriber operator, the 3,000 subscriber system will not be allowed to undo a rate cut made pursuant to the benchmark mechanism simply because it is now owned by a small operator.

[160] Such growth does not include the addition of subscribers through acquisition or merger. See para. 160, supra.

[161] We also recognize that, in choosing a 15,000 total subscriber cut-off, we may be excluding from transition relief some small operators who are just over the limit on March 31, 1994. To soften the impact of our revised rate regulations for such operators, we will allow operators whose subscriber base exceeds 15,000 total subscribers by no more than 1,000 subscribers to petition the Commission for emergency relief entitling them to transition treatment. Such petitions should be based on a showing that not treating the operator as a "small operator" will cause substantial hardship. A major factor in making this determination will be evidence regarding the operator's price/cost margin. For example, if the operator's systems have a density of 35 or fewer homes passed per mile, this would be one piece of evidence that the operator may have higher costs. See e.g., Televista Communications, Inc. Reply to Oppositions to Petitions for Reconsideration at 5 and Attachments A and B; Small Cable Business Association, Petition to File Supplemental Comments and Plan for Interim Relief for Low Density and Smaller Cable Businesses at Attachment A (Jan. 29, 1994).

123. The second class of regulated cable systems entitled to transition treatment are those whose March 31, 1994 rates are below the revised benchmark, and those whose March 31, 1994 rates are above the revised benchmark but whose full reduction rates are below the revised benchmark. These systems are charging comparatively low prices when measured against other noncompetitive systems, as indicated by their position relative to the new benchmark. As noted above, we have no conclusive evidence demonstrating that these "low-price" noncompetitive systems are not exercising the market power reflected in the 17 percent competitive differential that we found to exist, on average, between the rates charged by noncompetitive systems and systems subject to effective competition. In particular, we tested these low-price systems for various demand and cost characteristics and did not find that their rates significantly varied in any systematic way from those of all other noncompetitive systems.

124. Nonetheless, we remain concerned that, because their prices are significantly lower than those charged by most noncompetitive systems, systems in this second class may face unusual demand, cost or other influences that have not been captured in our analysis to date. Accordingly, to study this issue further, we will grant transition treatment to cable systems with relatively low prices (i.e., those with rate levels below the revised benchmark and those with rate levels above the revised benchmark but whose full reduction rates are below the benchmark). We note, however, that the record evidence to date leaves us unable to conclude that these systems should ultimately be exempted from the requirement to apply the full revised competitive differential. Thus, as with small operators subject to transition relief, systems with relatively low prices will be required to apply the full 17 percent competitive differential if additional analysis of their costs fails to demonstrate that a smaller competitive differential should be applied to them.[162]

125. In order to determine whether they are "low-price" systems entitled to transition relief, all systems that do not qualify for transition treatment under our "small operator" definition will be required to compare their March 31, 1994 rates to the new benchmark and to their

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[162] Again, as with small operators qualifying for transition treatment, no low-price system will be required to apply more than the 17 percent competitive differential at the conclusion of the price/cost analysis.

full reduction rates using FCC Form 1200. Systems whose March 31, 1994 rates[163] are below the revised benchmark, or whose March 31, 1994 rates are above the revised benchmark but whose full reduction rate is below the revised benchmark, will be eligible for transition treatment.

126. To compare its rates to the new benchmark, a cable system will first calculate its "regulated revenue per subscriber" for the franchise area at issue as of March 31, 1994. The "regulated revenue per subscriber" is the cable system's revenue from its basic and cable programming service tiers, plus its regulated equipment revenue, divided by its number of subscribers. The cable system will then calculate its "benchmark regulated revenue per subscriber" using the revised benchmark formula.[164] This benchmark rate will be based on the system's characteristics as of March 31, 1994.[165] The benchmark rate will incorporate the 17

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[163] As explained at note 154, supra, we are using March 31, 1994 as our measure for determining transition treatment because that date is the end of the first quarter in calendar year 1994. Moreover, use of March 31, 1994 as the start date should prevent operators from trying to change their rates before the benchmark comparison occurs to gain an advantage not intended by our rules. Systems that attempt to engage in such evasive behavior will be subject to sanctions under the evasion provisions of our rate rules.

[164] To ease the administrative burden on all cable systems, the Commission will make available authorized copies of a computer disk that contains an electronic version of FCC Forms 1200 and 1205 (the form for determining costs of regulated cable equipment and installation). This computerized form will enable a system simply to input the information needed to calculate its permitted program service and equipment rates. The computer will then perform the necessary calculations automatically, including applying the new benchmark formula.

We emphasize that comparisons to the benchmark will be made using the new, not the old, benchmark formula. Because the formula has been revised, operators will need to calculate whether they fall under the new benchmark; they cannot simply rely on the fact that they previously fell under the old benchmark.

[165] As noted previously, the benchmark formula has been revised to reflect an improved statistical and economic analysis. One of the most significant changes is that the formula now contains a number of new variables that we find to have a statistically significant impact on cable system rates.

percent competitive differential and will be adjusted for inflation to enable the cable system to make a proper comparison between its March 31, 1994 rates and the benchmark.[166]

c. Application of Transition Relief

127. Regulated cable systems eligible for transition relief, either because they are owned by small operators or because they are low-price, will not be required to adjust their rates to the full reduction rate level pending completion of the Commission's price/cost analysis. Rather, systems that are owned by small operators and systems whose March 31, 1994 rates are below the revised benchmark will not have to make any reductions at this time. Systems whose March 31, 1994 rates are above the revised benchmark but whose full reduction rates are below the revised benchmark will only be required to reduce those rate levels to, and not below, the revised benchmark during the transition period. We are not requiring these latter systems to reduce their rate levels below the revised benchmark for two related reasons. First, as noted above, we are studying further the question of whether below-benchmark rates are more likely to be reasonable than above-benchmark rates, because they are comparatively lower. In light of this outstanding inquiry, we do not believe it would be appropriate to require regulated systems to reduce their rates below the benchmark level at this time. Second, requiring any systems whose rates are currently slightly

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Variables in the old formula included whether a system was subject to effective competition, total number of regulated channels, number of subscribers to the cable system, and number of satellite-delivered signals. By contrast, variables in the new formula are based on: the number of channels on the system weighted by the proportion of subscribers taking each channel; the number of subscribers in the system; the proportion of nonbroadcast channels on the system; whether a system is a low penetration, overbuild or municipal system; whether a system is affiliated with a multiple system operator and the size of the multiple system operator; the proportions of subscribers with additional outlets, with remote controls, taking the lowest cable service tier, and changing tiers per year; and the median income in the system's area. See Technical Appendix at 12-19.

[166] This inflation adjustment is necessary because the benchmark formula is based on data reflecting industry rates as of September 30, 1992. The formula therefore must be inflated forward to March 31, 1994 to permit a comparison with a system's March 31, 1994 rates.

above the benchmark to reduce their rate levels to the full reduction levels, but not requiring below-benchmark systems to reduce their rates at all, would result in inequitable treatment of systems that may be fairly similarly situated.[167]

128. For purposes of applying the new rate rules, a system's March 31, 1994 rate is the rate that the system was permitted to charge under the old benchmark system, which in turn would consist of its initial permitted rate[168] plus any external costs that it accrued up to March 31, 1994.[169] We realize that some systems have already become subject to regulation at the local or federal level, and some have not. If, on March 31, 1994, a system is involved in a pending rate proceeding before either its local franchising authority or the FCC, its March 31, 1994 rate will be the rate that the regulator ultimately decides is reasonable.[170] It will also be subject to refund liability for the period during which its March 31, 1994 rate may have been

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[167] For example, a system whose current rate level is $30, whose benchmark is $28, and whose full reduction rate is $22.50 should not be required to reduce its rate to $22.50 during the transition period, given that a system with the same benchmark of $28 whose rate is $27 is not required to make any further rate reductions pending completion of our price/cost analysis. Thus, the operator with the $30 rate will only be required to reduce its rate to the benchmark - $28.

[168] Cable systems electing the benchmark approach use FCC Form 393 to determine their initial permitted rates as of the date they first become subject to regulation at the local or federal level.

[169] As described in para. 171, supra, cable systems are able to accrue external costs starting on either the date of initial regulation or February 28, 1994, whichever occurs earlier.

[170] This reasonable rate must include the external costs to which the system was entitled between the date of initial regulation for any tier (or February 28, 1994, whichever is earlier) and March 31, 1994.

If the March 31, 1994 rates used by the operator on FCC Form 1200 are subsequently found not to be lawful by a local or federal regulator, the operator will be required to update the rates submitted in the form to reflect the proper rates.

unlawfully high as measured under our current rules.[171] We impose this requirement because we do not intend for our transition approach to serve as a shield to rate reductions that may be required as a result of pending proceedings initiated under our prior rules. Similarly, if a system entitled to transition relief that is not already regulated becomes subject to regulation after March 31, 1994, it will be required to revise its rate and issue any relevant refunds[172] should the regulator determine that its March 31, 1994 rates were unlawful under our initial benchmark rules. This approach is necessary both to ensure that subscribers get the benefits of rate reductions to which they would have been entitled under the old rules, and to ensure that cable systems that became subject to regulation before May 15, 1994, the effective date of the new rules, are not treated differently (and more adversely) than systems that become subject to regulation after that date.

129. We also note that our decision to relieve systems entitled to transition treatment from immediate application of the full competitive differential does not relieve those systems of our other requirements concerning the restructuring of equipment and program service offerings. Thus, all regulated systems except those excused by specific provisions in our rules remain required to (1) set equipment rates at cost (including a reasonable profit), (2) unbundle equipment charges from programming rates, and (3) apply an average rate per channel when setting program tier charges.[173]

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[171] The system's refund liability obviously will cover any period during which it had such liability under application of our initial benchmark regulations. It will also, however, exist after May 15, 1994 under our revised rules and will be measured by the difference between the system's actual March 31, 1994 rate and the rate that the regulator ultimately determines was reasonable under the old benchmark rules. Any refund liability under the revised regulations will terminate when the system adjusts its rates to reflect the regulator's determination.

[172] See 47 C.F.R. Section 76.942.

[173] These requirements will not apply, however, to small systems serving 1,000 or fewer subscribers that are eligible for, and elect to implement, streamlined rate reductions which permit them to avoid these restructuring requirements as long as they implement a 14 percent line-item reduction for each regulated rate component that appears on subscribers' bills. See paras. 208-217, infra.

130. Systems eligible for transition relief will be subject to a modified price cap pending completion of the Commission's price/cost analysis. Specifically, these systems, like all other regulated systems, will have to compute their full reduction rate.[174] They will also have to calculate their "transition rate," which is simply the rate that they are permitted to charge at the beginning of their transition period.[175] Systems entitled to transition treatment may increase their rates to reflect increases in external costs and increases caused by channel changes that accrue after March 31, 1994.[176] We are permitting these particular rate increases because we wish to preserve sufficient incentives for systems to retain, and add, programming channels to regulated program services during the transition period, and both external costs and the "going-forward" methodology allow recovery of program-related expenses.

131. We will not allow such systems, however, to increase their transition rates due to increases in inflation until the transition rate equals their full reduction rate. Under the revised rules, a system's full reduction rate -- which, unlike its transition rate, rises

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[174] See para. 115, supra, for a discussion of how this rate is calculated. A system's full reduction rate will also be adjusted during the transition period to reflect changes in external costs, the number of regulated program channels and inflation.

[175] Thus, for systems owned by small operators and systems with below-benchmark rates, their "transition rate" will be their March 31, 1994 rate, as appropriately updated since that date. For systems whose March 31, 1994 rate is above the benchmark, but whose full reduction rate is below the benchmark, their "transition rate" will be the benchmark rate, as appropriately updated.

[176] Permitted increases in external costs will be determined pursuant to our external cost rules adopted in the Rate Order and subsequently modified herein and in the First Reconsideration Order. See Rate Order at paras. 241-257; First Recon. Order at paras. 87-123; see also infra at paras. 169-177. Increases due to subsequent channel changes in regulated tiers after the effective date of this Order will be governed by the "going-forward" methodology adopted in this Order. See paras. 231-249, infra. Channel changes occurring between September 30, 1992 and the date of initial regulation (or February 28, 1994, whichever occurs first) will be handled through application of the old benchmark methodology. See note 151 supra.

with inflation as well as with changes in external cost and channel changes -- may eventually exceed the transition rate. At the point when the transition rate and the full reduction rate become equal (if such a point occurs during the transition period), the system will be entitled to adjust its rate upward to take advantage of all future inflation adjustments. This process protects the cash flows of systems subject to transition relief, while gradually bringing their rates in line with the full reduction amounts. This smooth transition to full reduction rates should thus reduce the administrative and financial burdens of implementing the full competitive differential.[177]

d. Regulated Rates at the End of the Transition Period

132. In the near future, the Commission will initiate an industry cost study pursuant to our cost-of-service rulemaking proceeding.[178] Information about the prices and costs of small operators and low-priced systems will be collected as part of that effort. In addition, we will shortly issue a further notice in this proceeding to enable these systems to submit additional evidence to us concerning their prices and costs.

133. The Commission will use the information it receives in these proceedings to determine what competitive differentials ultimately are appropriate for the two classes of systems eligible for transition relief. The competitive differentials for each category will then be applied on a classwide basis.[179] In no instance will either class be subject to a competitive differential greater than 17 percent. Subject to that limitation, we expect to apply the largest competitive differential that is consistent with the average operator in each class earning the 11.25 percent rate of return that we are today adopting in our interim

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[177] As explained in the following section, at the end of the transition period, any system will be entitled to full future inflation adjustments once it has attained the full reduction rate corresponding to the competitive differential that has been determined to be appropriate for it as a result of our price/cost analysis.

[178] See Cost Proceeding.

[179] Regulated systems who believe that these industry figures do not provide them adequate rates may elect to make a cost-of-service showing.

cost-of-service rules.[180]

134. Once the appropriate competitive differential has been applied to a system, that system will be entitled to an "aggregate inflation adjustment" equal to all GNP-PI inflation adjustments for the period beginning October 1, 1992 through the most recent June 30. To the extent a system has already received some inflation adjustment for that period, the system will receive the net of the aggregate inflation adjustment minus any inflation adjustment already received. In either case, after the end of the transition period, a system will be eligible for additional inflation adjustments on an annual basis, but no earlier than September 30 of each year, when the final GNP-PI through June 30 of each year is released.

e. Calculation of Refund Liability

135. In general, regulated systems who select the benchmark approach to setting rates will be required to comply with the revised rules by May 15, 1994 in order to avoid refund liability. We recognize, however, that there may be some systems who will not be able to bring their regulated rates into compliance with the modified benchmark system by that time. Specifically, to comply with the new rules, operators will need to collect the necessary rate-setting information, complete the applicable FCC Forms to determine their new permitted rates, and give the required notice of any rate changes to their subscribers.[181] Although the Commission is making every effort to ensure that this process runs as smoothly as possible (by, for example, making FCC Form 1200 and related forms available on a computer disk), it is aware that some systems may have difficulty completing the necessary tasks before the effective date of the new rules.

136. Accordingly, to reduce the burden on cable systems that cannot conform their regulated rates to the new benchmark approach by the effective date of the revised rules, we will not impose refund liability on such systems

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[180] Stated differently, when evaluating the costs of systems entitled to transition treatment, we will not treat as a legitimate cost a rate of return that is above the 11.25 percent return that we have found is appropriate in our cost-of-service order.

[181] We are also in this Order revising our provisions concerning the notice that must be given to subscribers before a rate change is implemented. See paras. 139-143, infra.

for an additional 60 days after May 15, 1994 (i.e., until July 14, 1994), as long as certain conditions are met. First, systems wishing to take advantage of this deferral of refund liability may not change any rate for regulated service or equipment, or restructure any regulated service or equipment offering (by, for example, removing program channels from what would be regulated service tiers and placing them into an "a la carte" package), during the period that runs from the release date of this Order to July 14, 1994. Moreover, a cable system that does restructure its rates and service offerings, even in compliance with our rules, before July 14, 1994 will have its refund liability triggered on the date the restructuring occurs. These conditions are needed to ensure that cable systems do not attempt to game the benchmark process before the new rules take effect and during the refund deferral period.

137. Second, cable systems taking advantage of the refund deferral period must still give at least 30 days notice to subscribers of any rate or service changes they ultimately make in response to the new rules, as required under our revised notification provisions.[182] Our experience with the rate changes that occurred shortly before the initial rate regulations went into effect on September 1, 1993 revealed that many subscribers were surprised by the rate and service offering changes that were made because we had preempted all notification requirements. We believe that consumers are better served if they have sufficient warning that their rates and service offerings may change again, even if those changes primarily result in rate decreases.

138. Third, all rate and service restructuring must be completed by July 14, 1994 (the end of the 60-day deferral period) in order to avoid refund liability.[183] We believe that an additional two months beyond the effective date of

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[182] See infra para. 139. We will preempt any local and state requirements that require cable systems to give more than 30 days notice of rate and service changes to subscribers where application of the local and state provisions would serve to prevent a system from bringing its rates into compliance with the new benchmark rules by the end of the refund deferral period.

[183] Restructuring is considered to be completed when bills reflecting the rate and service changes have been issued to subscribers. If an operator has a staggered billing cycle, the relevant date will be the date on which the first cycle of bills is mailed, as long as the billing cycle is completed within 30 days from that date.

our new rules provides cable systems adequate time in which to familiarize themselves with the regulations and take the necessary actions to comply. This is particularly true given that rate regulation is already well under way for many operators.

f. Notice to Subscribers

139. The Commission's existing rate regulations require that cable systems give 30 days notice to franchising authorities of any rate increase.[184] Our customer service standards provide that systems must give 30 days notice to subscribers before implementing any rate or service changes.[185] These standards, however, are enforced in the first instance at the local level by local franchising authorities, and not primarily by the Commission.[186] In order to better ensure that consumers have sufficient notice of rate and service changes and to clarify operators' notification requirements, we are modifying our rate regulations to require that cable systems give 30 days notice to both subscribers and franchising authorities before implementing any rate or service changes.

140. In addition, our experience with the rate changes that occurred in the wake of rate regulation suggests that a number of cable subscribers have either not been informed or have been confused about the reasons for recent rate or service changes. To ameliorate this situation, we are expanding the notice requirement to ensure that cable operators provide consumers with better information about why rates or services are changing. In particular, cable systems will have to identify on subscriber bills the precise amount of any rate change and briefly explain its cause (e.g., inflation, changes in external costs or the addition/deletion of channels (identified by name)). This information must be presented in a way that enables the average subscriber to understand readily why his or her rates have increased or decreased.

141. In our April, 1993 Rate Order, we did not require that cable systems provide subscribers with information regarding how to lodge complaints about rate changes, but instead only required that notices of upcoming rate changes include the name and address of the system's local

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[184] Rate Order at para. 124; 47 C.F.R. Section 76.964.

[185] 47 C.F.R. Section 76.309(c)(3)(i).

[186] 47 C.F.R. Section 76.309 (a), (c).

franchising authority. We also did not require that rate change notices include the address of the Commission. Upon further consideration, we believe that it would impose little or no additional burden upon cable systems but would better serve consumers if systems were required to notify subscribers of their right to file complaints about changes in cable service tier rates and cable programming services with the Commission within 45 days of the change being reflected in their bill, and to provide the address and phone number of the local franchising authority and the Commission.[187] We believe these changes in our notice requirements will make it easier for subscribers to ask the Commission to investigate potentially unjustified changes in rates for cable programming services. In order to minimize burdens on cable operators, however, we also reaffirm our prior conclusion that the notice will not have to include a copy of our complaint form.[188]

142. These notice requirements are effective immediately upon publication of the revised rules in the Federal Register. We find good cause to make these requirements effective on less than 30 days notice in the Federal Register.[189]

143. In addition, we are requiring that all cable system bills to subscribers contain the address and phone number of the local franchising authority and the Commission. We believe that this requirement will impose little or no additional burden upon cable systems and will be useful to consumers.

g. Procedural Issues for Franchising Authorities

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[187] The address of the Commission is Federal Communications Commission, Cable Services Bureau, Consumer Protection Division, 1919 M Street, N.W., Washington D.C. 20554. The phone number is 202-416-0856.

[188] Rate Order at para. 124.

[189] See 5 U.S.C. Section 553(d)(3). Good cause exists because we believe it is important that the notice provisions set forth above apply to rate changes made pursuant to this Order. Were the normal 30-day period to apply, it would be possible for cable operators to revise their rates pursuant to this Order without complying with the notice provisions. For example, a cable operator could send a notice of rate changes pursuant to this Order on May 13, 1994, complying only with the notice requirements previously in effect and not providing, for example, the address and phone number of the Commission.

144. We realize that local franchising authorities and cable operators currently involved in proceedings concerning basic cable rates may have questions regarding the procedural deadlines that they must follow, given the adoption of our revised rate rules. As explained below, with one exception, we see no reason why franchising authorities and cable operators should deviate from the timeframes already established in Sections 76.930 and 76.933 of our Rules for proceedings that were initiated before the effective date of this Order. Thus, adoption of this Order generally does not affect the basic deadlines to which local authorities and operators must adhere for resolving pending rate cases under our initial benchmark regulations. Moreover, as detailed below, all operators involved in a pending case will be required to submit a rate justification on the required FCC Forms within 30 days after the revised rules take effect on May 15, 1994.[190]

145. We believe that there are generally five points in the rate-setting process that a local franchising authority and cable operator may be on May 15, 1994. The first is where the franchising authority has not certified to regulate basic rates by that date, or has certified but has not yet notified the operator that it is commencing basic rate regulation. In this case, the cable system will be required to file both an FCC Form 393 and new FCC Form 1200 30 days after the local authority notifies it that the authority is initiating rate regulation of the basic service tier.[191] FCC Form 393 will be used to determine the operator's permitted rates from September 1, 1993 until May 15, 1994, and FCC Form 1200 will be used to determine its permitted rates after May 15, 1994. The franchising authority will then be expected to examine both filings

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[190] In all relevant cases, if the operator elects to take advantage of the deferral of refund liability period described above at para. 135-138, supra, it must notify the local franchising authority by the date on which its rate justification on an FCC Form is due that it is electing that option. The system will then have 30 days from the date on which it ultimately restructures its rates to submit the relevant FCC forms, although in no event will such forms be filed more than 30 days after July 14, 1994, the last date of the refund liability deferral period.

[191] It will not be necessary to file an FCC Form 393, however, if the one-year time limit on the operator's refund liability precludes any possibility of refund for the period before the effective date of the revised rules. See Section 76.942.

within the timeframes established in Section 76.933.

146. Second, if, by May 15, 1994, a franchising authority has notified the cable operator that it has become certified, but the operator has not yet submitted the required FCC form (e.g., because the 30 day response period has not lapsed), we will require the cable operator to file both FCC Form 393 and new FCC Form 1200 within 30 days after May 15, 1994.[192] We believe this limited deviation from Section 76.930 of our rules, which requires the cable operator to file its schedule of rates within 30 days of the date of a written request from the franchising authority, is justified because it will allow the operator to complete both forms simultaneously, with minimal disruption to the franchising authority. The franchising authority will be expected to examine both filings within the time periods established in Section 76.933.

147. Third, if, by May 15, 1994, a franchising authority has received the cable operator's filing for justifying rates under the old benchmark system but has not reached a final decision pursuant to Sections 76.933 or 76.936 of our rules, we expect the franchising authority to follow all existing timeframes with respect to that part of the proceeding.[193] The cable operator in this situation will also be required to file new FCC Form 1200 with the

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[192] There is one exception to this rule. In our Third Recon. Order in this docket, we make clear that franchising authorities have the power to impose sanctions, including findings of default, on cable operators who fail to file documents relevant to a rate determination in response to requests from the franchising authority. We will permit any cable operator who has not filed a requested FCC Form 393 within the 30 day time period established in Section 76.930 to do so by the effective date of these rules. If the operator fails to do so, the franchising authority will be permitted to apply the sanctions outlined in our Third Recon. Order in this docket.

[193] Franchising authorities are reminded that they may issue an accounting order requesting that the cable operator keep a record of its rates if the authority is unable to reach a rate determination within the prescribed time period. See 47 C.F.R. Section 76.933(c). If the authority later determines that the operator's basic rates were unlawfully high, the operator's refund liability will extend from the date the accounting order was issued up to the date on which the operator eventually adjusts its rate in response to the franchising authority's decision, and then back for a period not to exceed one year. See 47 C.F.R. Section 76.942(c); Rate Order at para. 142, n.376.

franchising authority within 30 days of May 15, 1994. The franchising authority will then resolve the second portion of the proceeding, in which it will evaluate the cable operator's rates under the revised rules, according to the separate timeframes established in Section 76.933.[194]

148. Fourth, if, by May 15, 1994, a franchising authority has reached a final decision about the lawfulness of an operator's basic rates under our initial rate rules, we will require the cable operator to file new FCC Form 1200 within thirty days of May 15, 1994. The franchising authority will then examine the form pursuant to the time frames established in Section 76.933.

149. Finally, if a franchising authority has reached a final decision on the cable operator's rates, and a rate increase request is pending as of May 15, 1994, the cable operator will be required to file new FCC Form 1200 within thirty days of May 15, 1994. The rate increase request will then be evaluated pursuant to the data submitted on the FCC Form 1200, rather than by any data that had already been submitted by the operator in support of its rate increase request.[195]

h. Pending Complaints Before the Commission

150. There are currently a number of complaints regarding rates for cable programming services tiers pending before the Commission. Unless we have issued a decision on a pending complaint before May 15, 1994, the operator about whom the complaint was made must file an FCC Form 1200 in addition to the FCC Form 393 it either has filed or must file. Such operators will be subject to refund liability calculated under our initial regulations for rates that were in effect from September 1, 1993 until May 15, 1994 (although obviously any refund liability will not start

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[194] We do not establish special provisions to address situations where franchising authorities have failed to issue extension orders for pending local rate proceedings as permitted under current rules. Presumably, local authorities that have not extended the time for completion of local proceedings have determined that additional time is not necessary.

[195] This is because the FCC Form 1200, in addition to computing the operator's initial permitted rate on May 15, 1994, also calculates permitted rate increases that may have occurred through the first quarter of 1994. Operators will be able to file rate justifications after June 30, 1994 to reflect external costs incurred during the second quarter of 1994.

until the complaint was filed). Refund liability with respect to rates charged on and after May 15, 1994 will be calculated pursuant to the revised rules adopted in this Order.[196]

151. Our reason for imposing this requirement is that most operators whose rates did not comply with our former rules also will be in violation of our new rules due to the increased competitive differential. Therefore, in most cases, a valid complaint made prior to the effective date of these new rules will remain valid. In addition, rates that may have been permissible under our former rules may be in violation of our new rules. Requiring operators against whom a complaint has been filed to submit an FCC Form 1200 thus will enable us to determine whether those operators are currently complying with our rules, regardless of their status under our initial rules.

152. To the extent there is a complaint regarding cable programming service tier rates pending before the Commission, we will continue to require the cable operator in question to file notice of any changes in rates with the Commission.[197] This notice must be filed at least 30 days before such rates are proposed to be effective. This notice is necessary to allow the Commission to ensure that the cable service tier rate is not unreasonable.

5. Commission Authority to Adopt the Modified Ratemaking Approach

153. We conclude that the modified ratemaking approach we now adopt is consistent with our statutory authority under the Cable Act of 1992. Section 623(b)(1) of the Communications Act, 47 U.S.C. Section 543(b)(1), mandates that the Commission ensure that rates for the basic service tier are "reasonable." In addition, regulated upper tier rates may not be "unreasonable." Section 623(c)(1), 47

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[196] As with basic tier regulation, if the operator elects to take advantage of the deferral of refund liability period described at para. 135-138, supra, it must notify the Commission by the date on which its rate justification on an FCC Form is due that it is electing that option. The system will then have 30 days from the date on which it ultimately restructures its rates to submit the relevant FCC forms, although in no event will such forms be filed more than 30 days after July 14, 1994, the last date of the refund liability deferral period.

[197] See FCC Form 393 at page 2 (General Instruction 1).

U.S.C. Section 543(c)(1).[198] Nothing in the Cable Act of 1992 compels the use of a specific ratemaking model to ensure that rates are reasonable. Rather, Section 623(b)(1) of the Act, 47 U.S.C. Section 543(b)(1), specifies that the "goal" is "protecting subscribers" from higher rates than would be charged if all cable systems were subject to "effective competition." Sections 623(b)(2)(C) and 623(c)(2) of the Act, 47 U.S.C. Sections 543(b)(2)(C) and 543(c)(2), also set forth various factors the Commission must consider in establishing its ratemaking approach, but the statute leaves to the Commission the way in which these factors should be taken into account.

154. Indeed, Congress specifically rejected the approach mandated by the House bill, which would have required the Commission to establish a formula to set the maximum price for basic tier service.[199] As enacted, Section 623(b)(2)(B) of the Act, 47 U.S.C. Section 543(b)(2)(B), instead provides that the Commission "may adopt formulas or other mechanisms and procedures." The legislative history explains:

> Rather than requiring the Commission to adopt a formula to set a maximum rate for basic cable service, the conferees agree to allow the Commission to adopt formulas or other mechanisms and procedures to carry out this purpose. The purpose of these changes is to give the Commission the authority to choose the best method of ensuring reasonable rates for the basic service tier and to encourage the Commission to simplify the regulatory process.[200]

Thus, the statute does not require us to craft a benchmark system of regulation, to calculate an estimated competitive differential, or to use any particular weighing methodology

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[198] The Commission previously has concluded that there is no distinction to be drawn between the statute's use of different language for basic tier service (ensuring reasonable rates) and regulated upper tier service (determining rates to be unreasonable). See Rate Order at paras. 387-389. On reconsideration, the Commission affirmed this conclusion. First Recon. Order, at paras. 32-36. Accordingly, our discussion here applies to our ratemaking approach for both basic service tier rates and cable programming service rates.

[199] House Report at 5.

[200] Conference Report at 62.

to calculate the competitive differential.

155. More generally, the courts have recognized that regulatory agencies are afforded wide latitude in discharging their ratemaking functions. Rather than insisting upon a single regulatory method for determining reasonable rates, courts evaluate whether the "end result" of a particular regulatory scheme results in rates that are within a "zone of reasonableness."[201] Ratemaking under the Communications Act and similar statutes "is not an exact science."[202] It involves both quantitative and qualitative judgments and predictions about the future. Thus, courts have stressed that "neither law nor economics has yet devised generally accepted standards for the evaluation of ratemaking orders."[203] Moreover, as one court has noted in reviewing the exercise of our ratemaking power in the telephone context, ratemaking decisions "are appropriately treated as policy determinations in which the agency is

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[201] See FERC v. Pennzoil Producing Co., 439 U.S. 508, 517 (1979); Permian Basin Area Rate Cases, 390 U.S. 747, 797 (1968); Jersey Cent. Power & Light Co. v. FERC, 810 F.2d 1168, 1177 (D.C. Cir. 1987), quoting, Washington Gas Light Co. v. Baker, 188 F.2d 11, 15 (D.C. Cir. 1950), cert. denied., 340 U.S. 952 (1951). See also FPC v. Hope Natural Gas Co., 320 U.S. 591, 602 (1944) ("it is the result reached not the method employed that is controlling"). Accord Illinois Bell Tel. Co. v. FCC, 988 F.2d 1254, 1260 (D.C. Cir. 1993).

[202] United States v. FCC, 707 F.2d 610, 618 (D.C. Cir. 1983).

[203] Permian Basin, 390 U.S. at 790, quoted in United States v. FCC, 707 F.2d. at 618. In other contexts as well, courts have recognized that there is not necessarily a "correct" answer when agencies draw lines. See ALLTEL Corp. v. FCC, 838 F.2d 551, 559 (D.C. Cir. 1988) (an agency's "selection of a precise point on a scale" will be accorded deference unless the scale "has 'no relationship to the underlying regulatory problem'") (quoting Home Box Office, Inc. v. FCC, 567 F.2d 9, 60 (D.C. Cir. 1977), cert. den., 434 U.S. 829 (1977)); MCI Telecommunications Corp. v. FCC, 627 F.2d 322, 341 (D.C. Cir. 1980) ("[t]he best must not become the enemy of the good"); Storer Broadcasting Co. v. FCC, 240 F.2d 55, 56 (D.C. Cir. 1956) ("specific numerical limitations" in the FCC's multiple ownership rules "may not be upset" where "[o]ur attention has not been drawn to any matters which outweigh [the FCC's] judgment based upon 'accumulating insight'") (quoting FCC v. RCA, 346 U.S. 86, 96 (1953)).